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COST AND BENEFIT PROJECTIONS FOR A CIVIL SERVICE RETIREMENT PLAN FOR FEDERAL EMPLOYEES COVERED BY SOCIAL SECURITY

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I. GENERAL DESCRIPTION

This pension design is for Federal civil servants who are covered by social security. Workers first hired after January 1, 1984 would automatically participate as would certain other categories of workers with service before that date. Employees exempted from participation in social security would be given an option to waive that exemption and become participants in this arrangement.

The general design of the system includes, in addition to social security, a defined benefit plan and a capital accumulation plan. Workers would participate automatically in the defined benefit plan which would be entirely funded from Federal funds.

A defined benefit plan is one in which a formula and a definition of eligibility determine benefit awards. In this case, workers would earn .85 of a percent of the average of their highest five years of wages for each year of service completed. Basic benefits from the defined benefit pension would be fully payable at age 62 with 10 years of service. Workers could choose to retire at age 55 with 30 years of service, and could be eligible for benefits if involuntarily separated at age 50 with 20 years of service or at any age with 25 years. Retirement benefits received before age 62 are to be reduced by two percent for each year under that age.

A voluntary capital accumulation plan is one in which an employee accumulates assets in the form of a savings account that can be converted to either a lump sum or an annuity at the point at which the employee retires. In this proposal, a program of individual capital accumulation accounts is created from employee money voluntarily contributed, with Federal funds added to encourage participation. Employees would be permitted to contribute up to 10 percent of their salaries to the plan, with the first four percent matched by two dollars for each dollar contributed. The proposal envisions that these individual accounts would be gradually opened to employee discretion as to the specific investment vehicle for the account's assets. Under certain conditions, employees would have access to their funds before retirement. If an employee separates from Federal service before becoming eligible to receive an annuity, the accumulated sums could be transferred to an Individual Retirement Account (IRA).

Disabled workers are guaranteed a minimum of 60 percent of their salary base for one year, minus any payable social security. After one year, disabled workers who would not qualify for social security disability but who are not fully capable of resuming Federal employment would receive the lesser of 20 percent of their salary base at the onset of disability, or their accrued retirement benefit with service projected to age 62.

Survivors of workers and retirees could be eligible for benefits with amounts and eligibility determined by various circumstances, including service of the deceased worker or retiree, existence of other family dependents, eligibility for social security and age of the surviving beneficiary.

II. PLAN PROVISIONS

TABLE 1. Plan Provisions

	Current CSRS	Senator Stevens' Plan
A. Social Security		
Social security (Old age, survivors, and disability insurance cash benefits)	None	All affected employees covered
B. Defined Benefit Retirement		
Basic plan design	Defined benefit	Defined benefit not integrated (fully added to social security)
Required employee contributions	7% of total pay	5.7% of pay (6.06 beginning in 1988; 6.20 beginning in 1990) to social security (for OASDI coverage) up to maximum taxable wage base ($39,600 in 1985) No required contribution to new CSRS
Vesting	5 yrs. for retirement	10 yrs. for retirement and
	1.5 yrs. for disability	1.5 yrs. for disability
	1.5 yrs. for preretire-death benefits	1.5 yrs. for preretirement death benefits
Salary base	Average of HI-3 yrs. salary	Average of HI-5 yrs. salary

TABLE 1. Plan Provisions--Continued

	Current CSRS	Senator Stevens' Plan
Retirement benefit formula (accrual rate)	1.5% x first 5 yrs. of service. 1.75% x second 5 yrs. of service. 2.0 x all yrs of service over 10 years; all x salary base	.85 x yrs. of services
Age for unreduced retirement benefits	Age 55 with 30 yrs. service. 60 with 20 yrs. service. 62 with 5 yrs. service	62 with 10 yrs. service
Early retirement; age and reductions	No provisions	55 with 30 yrs. service. Benefit reduced 2% for each year under age 62
Involuntary early retirement; age and reductions	Age 50 with 20 yrs. service. Any age with 25 yrs. of service. Benefit reduced 2% for each year under age 55	Same as current, but benefit reduced 2% for each year under age 62
Deferred retirement	At least 5 yrs. service; accrued benefit payable at age 62	At least 10 yrs. service; accrued benefit payable at age 62
Refunds	Option to withdraw at separation sums contributed with benefits forfeited	No contributions, thus no refund
Cost-of-living adjustments	Annually, full rate of inflation measured by Consumer Price Index	Annually, rate of inflation measured by Consumer Price Index, minus 2%

C. Disability Benefits

	Annuity earned at onset or, (a) 40% of salary base, or (b) the annuity that would be paid projecting service to age 60 at the same salary base	60% of salary base minus 100% of primary social security benefit; workers not qualified for social security disability are reduced after one year to the lower of: (a) 20% of salary base, or (b) accrued benefit based on service projected to age 62

TABLE 1. Plan Provisions--Continued

	Current CSRS	Senator Stevens' Plan
D. Survivor Benefits		
Preretirement death benefit, spouse	55% of the annuity earned at death, or, if larger the lesser of (a) 55% of 40% of salary base, or (b) 55% of annuity earned with service projected to age 60 at same salary base	Survivors get the higher of: (1) 50% of the accrued annuity (computed as if the worker had retired the day before death, with any applicable early retirement reductions, but without the reduction for survivor benefits) plus any social security payable
Preretirement death benefit, children	Unrelated to annuity; annually adjusted dollar amount varied by number of children, and whether or not orphaned	None from plan; benefits provided by social security
Optional post-retirement death benefit, spouse	55% of earned retirement annuity unless choice rejected; option results in reduction to earned retirement annuity of 2.5% of first $3600 of annuity and 10% reduction to annuity over $3600	(a) annuity to married retiree automatically reduced actuarially as in a 50% joint-and-survivor plan to provide a spouse survivor annuity (b) survivors age 60 or over with no children under age 16 get 50% of the unreduced annuity (except for early retirement reduction) plus any social security payable (71.5% of PIA at age 60; 100% of PIA at age 65) (c) survivors under age 60 with no children of the retiree under age 16 get the full annuity that was payable to the retiree (after reductions for early retirement and survivor benefits) until age 60, when they will get 50% of the accrued annuity after early retirement reductions

TABLE 1. Plan Provisions--Continued

	Current CSRS	Senator Stevens' Plan
Options post-retirement death benefit, spouse (cont'd)		(d) survivors under age 60 with child(ren) of the retiree under age 16 get 50% of the unreduced annuity plus any social security mother's or father's benefits payable up to the family maximum (between 150% and 180% of the PIA)
Children	Same as for preretirement death benefit	None from plan; benefits provided by social security
E. Voluntary Capital Accumulation		
	No provision	Employees permitted to contribute up to 10% of pay to tax-deferred plan; Government adds $2 for each employee $1 to employee-owned account up to a maximum employee contribution of 4%; employee immediately vested for own contributions; employer contributions vested on schedule of vesting beginning at 25% after 2nd year to full vesting after 5th year
F. Special Provisions		
	Several classes of special age requirements, accrual rates, and guarantees	Law enforcement, firefighters, and air traffic controllers eligible to retire at age 55 with 25 yrs., supplement equivalent to social security payable until age 62. Other special groups become part of main program

III. COSTS

The following table displays the normal costs of this proposal. Table 2 compares the cost of the proposal to the cost of the current CSRS, using a consistent set of assumptions. The CRS model projects that the cost to the Federal Government of the proposal would be 13 to 15 percent less than the current CSRS, over a 75-year projection period.

TABLE 2. Comparison of Cost of Current CSRS to Proposal

	Current CSRS (baseline)			Proposal		
	Employer share	Employee share	Total	Employer share	Employee share (average)	Total
Retirement plans	25.2%	7.0%	32.2%	9.8%	--	9.8%
Social security a/	--	--	--	6.1	6.1	12.2 b/
Capital accumulation plan (voluntary) c/	--	--	--	6.1	3.1	9.2
Full cost d/	25.2	7.0	32.2	22.0	9.2	31.3

a/ Social security cost is the percentage of total Federal payroll taxable for social security (OASDI).

b/ Approximately .4 percent of payroll of the social security cost is not distributed to Federal workers, but flows to relatively lower-income social security participants outside the Federal Government.

c/ For employees, cost of the capital accumulation plan is the projected sum of all contributions (up to the specified matching limit of four percent for each employee) divided by the number of employees, assuming 78 percent rate of full participation. The cost to the government is the employee cost times the matching rate, minus .1 percent of payroll for savings achieved from matching amounts forfeited by employees who separate with less than five years of service.

d/ Average full cost after distributing costs of the capital accumulation plan.

IV. REPLACEMENT RATES

The following table and figures show percent of gross preretirement dollars replaced by the various retirement income components. For these benefit projections, employees are assumed to be retiring in 2030, after all enacted changes to social security retirement age have been phased in. In 2030, the age for full social security benefits is 67 with 30 percent reduction applied to benefits received at age 62. The table shows replacement rates for single workers, by salary level, age at retirement, and service, with benefit values shown at retirement age, at age 62 and age 80. Totals are given for retirees who participated fully (up to four percent) in the matched portion of the capital accumulation plan, and for those who did not participate at all. Capital accumulation amounts are indexed so that level values over time are shown. The figures show replacement rates for these combinations graphically and compares them to the current system.

TABLE 3. Percent of Preretirement Earnings Replaced by Various Components (single workers)

Age/years of service	Final salaries $15,000	$30,000	$45,000	$65,000
Age 55/30				
Total	36%	36%	36%	36%
(w/o CAP)	19	19	19	19
Pension	19	19	19	19
Pre-62 supplement	--	--	--	--
CAP	17	17	17	17
Total at age 62	55	50	46	43
(w/o CAP)	38	34	30	26
Pension	17	17	17	17
OASDI	21	17	13	10
CAP	17	17	17	17
Total at age 80	50	45	41	38
(w/o CAP)	33	29	25	21
Pension	12	12	12	12
OASDI	21	17	13	10
CAP	17	17	17	17
Age 62/30				
Total	64	59	55	52
(w/o CAP)	44	39	35	32
Pension	22	22	22	22
OASDI	21	17	13	10
CAP	20	20	20	20
Total at age 80	57	53	49	45
(w/o CAP)	37	33	29	25
Pension	16	16	16	16
OASDI	21	17	13	10
CAP	20	20	20	20
Age 62/20				
Total	43	40	38	35
(w/o CAP)	29	26	24	21
Pension	15	15	15	15
OASDI	14	11	9	6
CAP	14	14	14	14
Total at age 80	38	36	33	31
(w/o CAP)	24	22	19	17
Pension	10	10	10	10
OASDI	14	11	9	6
CAP	14	14	14	14

TABLE 3. Percent of Preretirement Earnings Replaced by Various Components--Continued

Age/years of service	Final salaries $15,000	$30,000	$45,000	$65,000
Age 62/10				
Total	22	21	20	19
(w/o CAP)	13	12	11	10
Pension	7	7	7	7
OASDI	6	5	4	3
CAP	9	9	9	9
Total at age 80	20	19	18	17
(w/o CAP)	11	10	9	8
Pension	5	5	5	5
OASDI	6	5	4	3
CAP	9	9	9	9
Age 67/40				
Total	100	91	85	78
(w/o CAP)	67	59	52	46
Pension	30	30	30	30
OASDI	37	28	22	16
CAP	33	33	33	33
Total at age 80	93	84	78	72
(w/o CAP)	61	52	45	39
Pension	24	24	24	24
OASDI	37	28	22	16
CAP	33	33	33	33

NOTE: Totals may not add due to rounding.

FIGURE 1. Replacement Rates for Workers at Different Salaries Retiring at Age 55 with 30 Years of Service

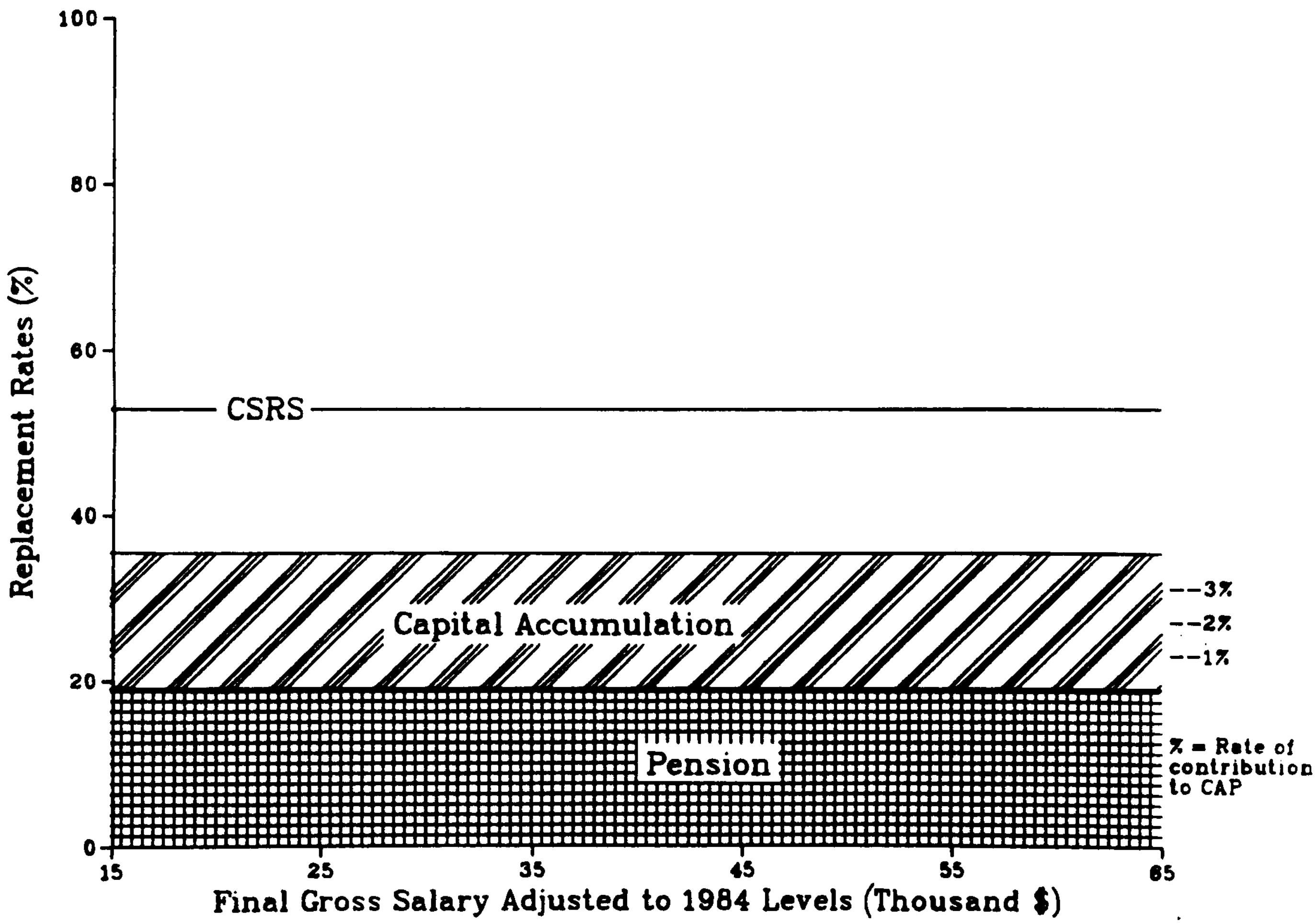


FIGURE 2. Replacement Rates for Workers at Different Salaries Retiring at Age 62 with 30 Years of Service

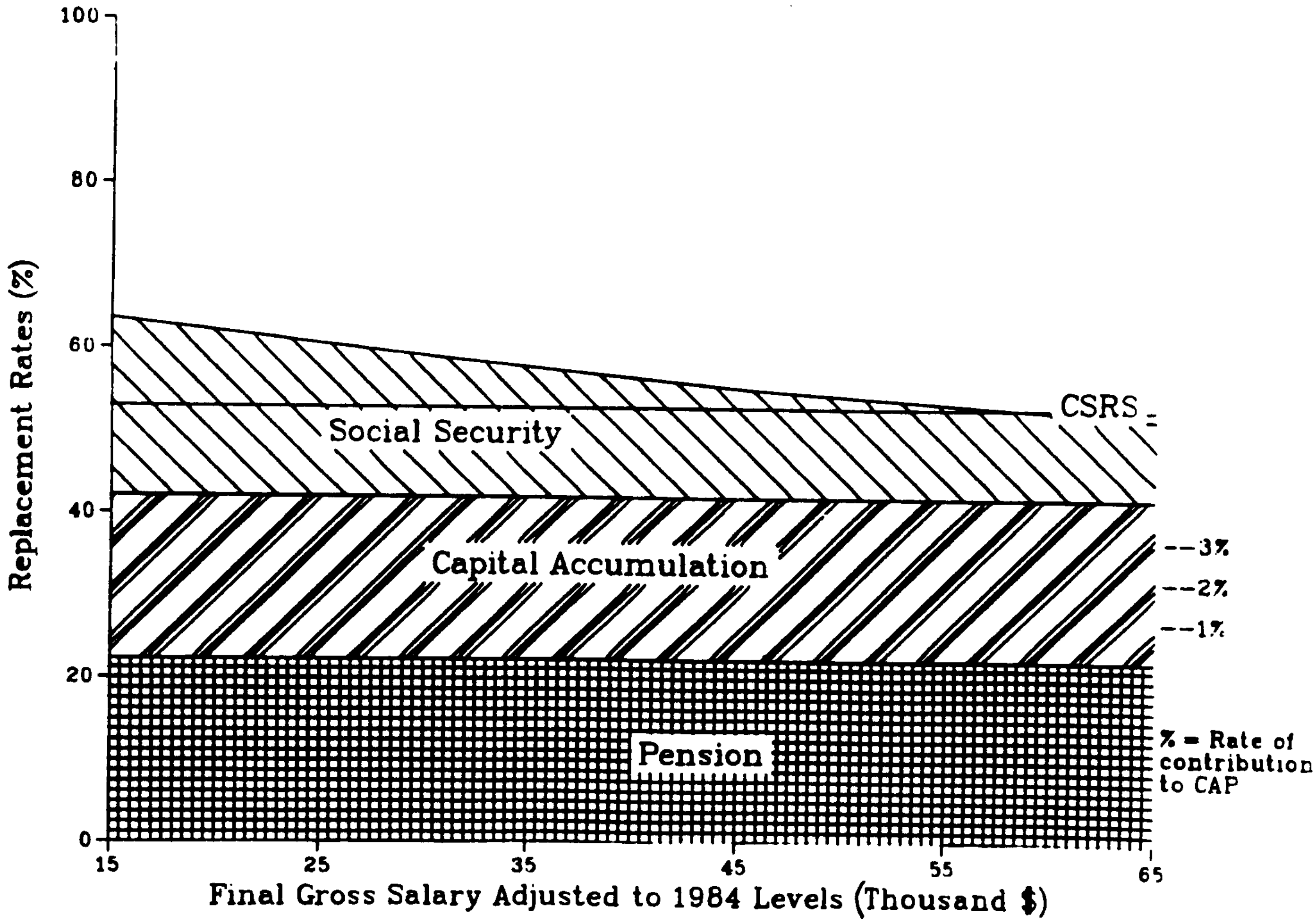


FIGURE 3. Replacement Rates for Workers Retiring at Age 62 with Different Combinations of Salary and Service

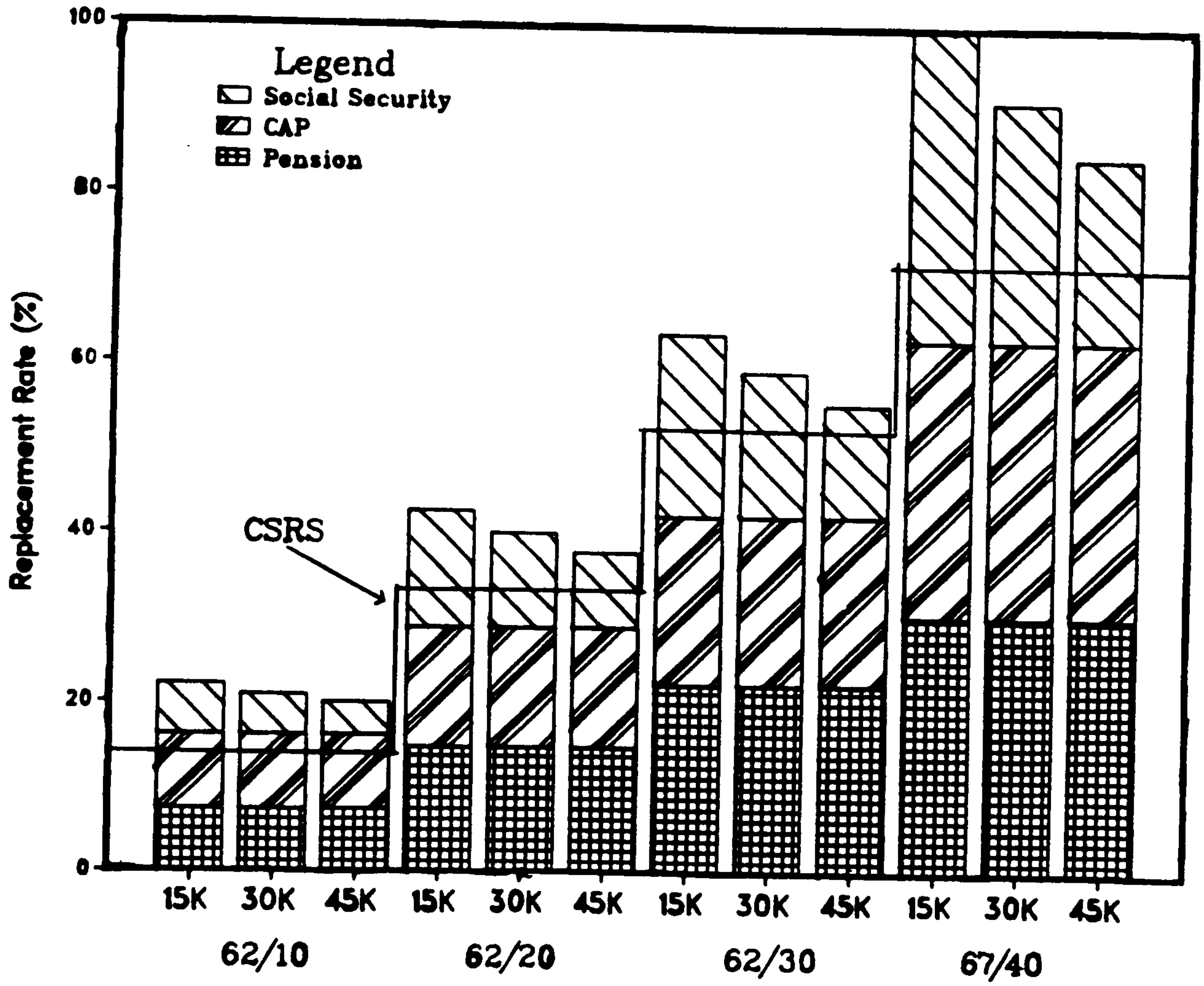


FIGURE 4. Replacement Rates Over Time for Workers Retiring at Age 55 with 30 Years of Service and a Final Salary of $30,000 (salary adjusted to 1984 levels)

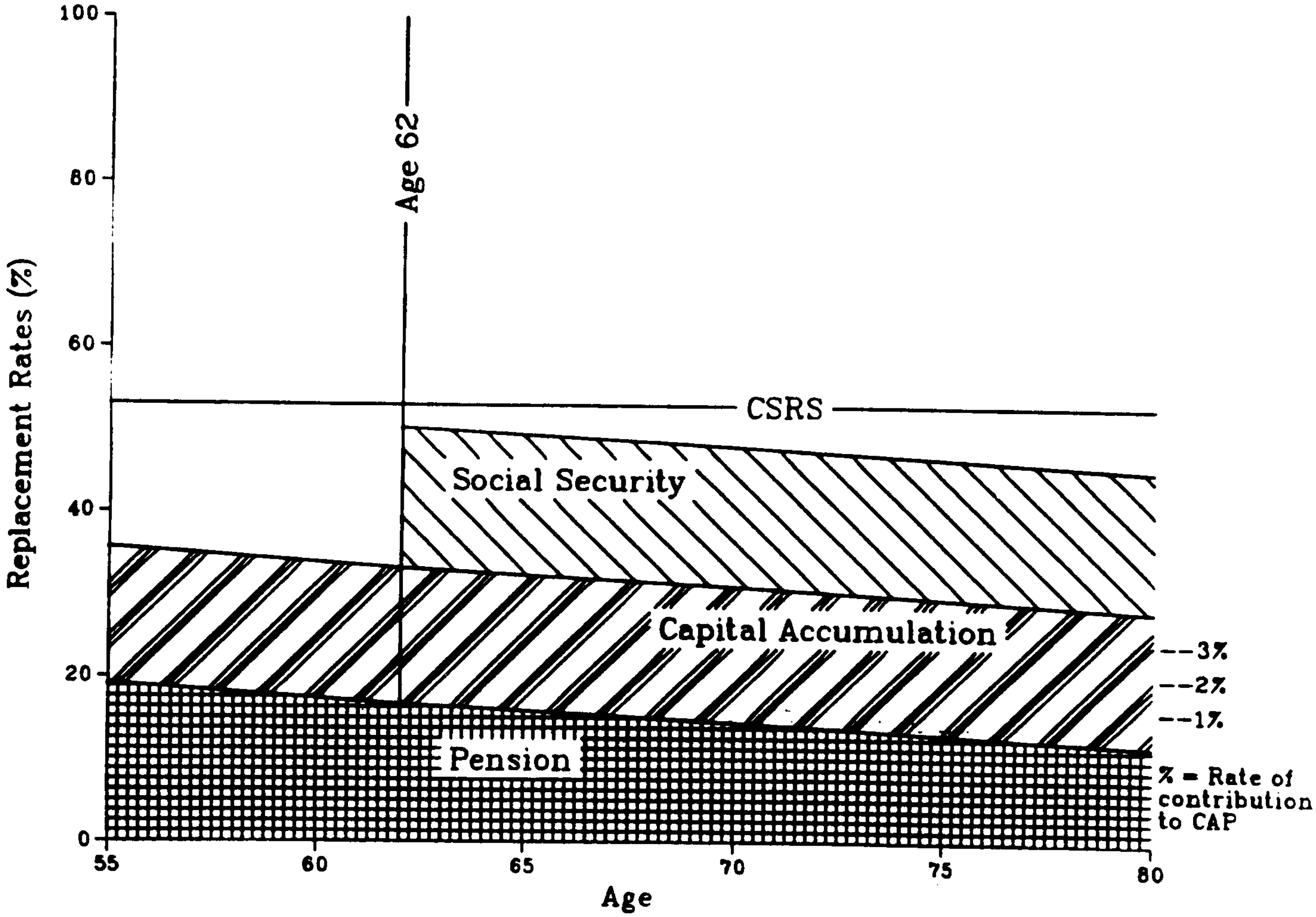
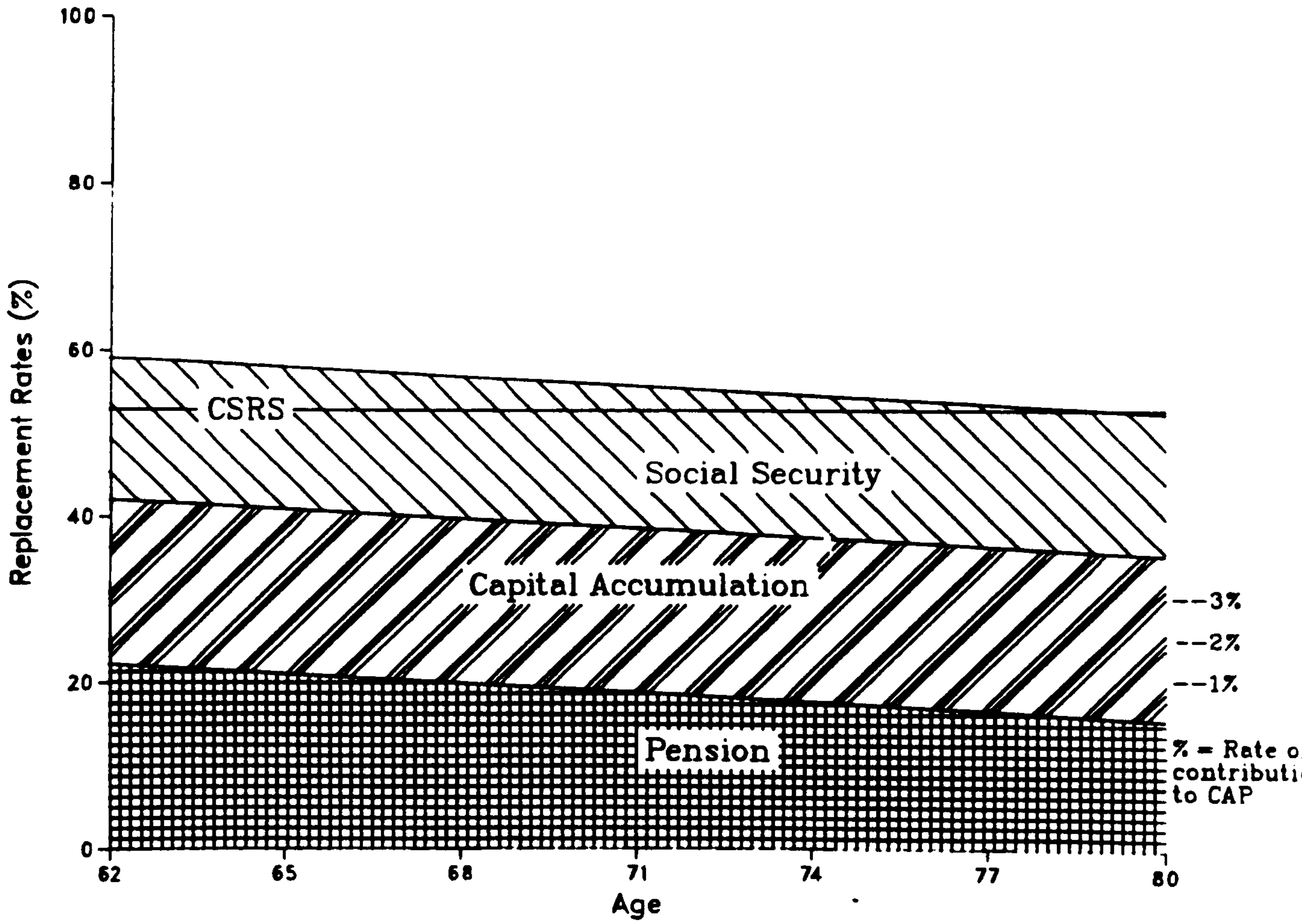


FIGURE 5. Replacement Rates Over Time for Workers Retiring at Age 62 with 30 Years of Service and a Final Salary of $30,000 (salary adjusted to 1984 levels)



V. METHODOLOGICAL SUPPORT

A. Cost and Replacement Rate Models

The estimates of retirement costs and benefits presented in this analysis were generated using the Congressional Research Service's cost and replacement rate models. These computer-based actuarial models were developed by CRS with actuarial support and a Pension Valuation Language (PVL) provided under contract by Hay-Huggins, Inc., an actuarial consulting firm. It should be noted that these models are projections of future outcomes. While such projections are valuable tools for making relative cost and benefit comparisons, it is inappropriate to imply or to seek a degree of accuracy that is in principle unattainable.

1. Cost Model

The cost model projects long-term costs of pension designs. The approach used is known as "entry age normal cost," and can be generally understood as the percentage of every paycheck that should be invested, over the total career of each employee in a group of new entrants, to pay fully for all benefits received by that group, including all eligible survivors. Normal cost is formally defined as the present value of future benefits divided by the present value of future compensation. These values are expressed as a percentage of payroll, and provide a consistent measure of relative pension costs over time.

2. Replacement Rate Model

The replacement rate model projects the percentage of preretirement wages replaced by postretirement benefits. This percentage can be shown at retirement and at various ages after retirement, with the latter expressed in values relative to purchasing power at retirement. Capital accumulation replacement rates assume the purchase of an annuity indexed to the assumed rate of inflation.

B. Data and Assumptions

The cost and replacement rate models required the use of certain data and assumptions, in order to project cost and benefit outcomes for employees entering work in 1984 and retiring in the year 2030. A profile of the Federal workforce into the future was drawn from data of the current system, and other factors pertaining to costs and benefits were identified and assumptions about the relative weight of those factors were made. Complete documentation of the methodology, data and basis for all assumptions is available from CRS.

1. Demographic Assumptions

Given the order of magnitude of Federal employment, fairly reliable data on the Federal workforce could be obtained, and was used whenever appropriate. The vast majority of the data used to construct a demographic profile of the Federal workforce was provided by the Office of Personnel Management (OPM). These data included career patterns, mortality and disability rates, probability of leaving a surviving dependent, etc. Certain modifications were made to the OPM data to maintain a constant career improvement pattern over time, and social security estimations of future improvements in mortality were also incorporated.

2. Economic Assumptions

All economic assumptions were taken from the 1984 Social Security Trustees' Report under the designation, "Intermediate II-B." The II-B assumptions are widely used, and are considered to be the social security actuaries' best estimates of future economic developments, without being particularly optimistic or pessimistic. When the 1985 Trustees' report is issued, CRS will incorporate any changes to II-B into the cost and replacement rate models. For 1984, the assumptions were: Interest, 6.1 percent, wages, 5.5 percent and prices, 4.0 percent.

3. Behaviorial Assumptions

Changes in plan designs relative to one another will cause changes in behavior which in turn affect plan costs. The changes in assumed rates of retirement, separation, etc., were made by the actuarial consultant, after research and discussions with CRS staff.

4. The Cost of Social Security

Generally, the cost of social security to its participants is the same as the tax that must be paid to the program. For these estimates, the cost of social security is the ratio of social security (OASDI) taxes to total Federal payroll over the 75-year period of the projection, evenly divided between employees and the Federal Government as employer. Under social security II-B assumptions, the benefits and taxes of the program are roughly in balance over that period, if the tax on social security benefits is treated as a revenue to the program. It should be noted, however, that some of the social security taxes on Federal payroll are not received back by Federal workers in the form of benefits because the average of Federal wages covered by social security exceeds the average covered wage in employment outside the Federal Government. Because the social security formula enhances the benefits of lower-paid workers, approximately .4 percent of payroll of the tax credited to social security from Federal wages is redistributed to workers outside the Federal Government. If the Federal Government is viewed, not as an employer, but in its other role as participant in the national economy, this redistributed amount could be construed as a savings.

Other differences in the pattern of payments between the present CSRS and social security are also taken into consideration when costs or replacement rates for a new plan incorporating social security are compared to the current system. The value of this difference ranges from two to three percent of payroll. About two-thirds of the difference is attributable to the portable rights to social security earnings credits retained by employees who leave employment with less than a full career. The remainder of the difference, after certain offsets and overlaps are netted, is attributable to dependents' benefits payable under social security but not payable from the current CSRS. The sum of these differences in the pattern of payments has been distributed across the various benefit components of the proposal and is thus reflected in lower replacement rates at retirement (excluding benefits from capital accumulation) of about five percent of total benefits attributable to the employer share of total plan costs.

5. Estimated Capital Accumulation Costs

Costs of the capital accumulation plans analyzed by CRS depend on the participation rate of individuals. Such rates, expressed as "percent of full participation," are influenced by two features of the plan: The rate at which employee payments to the capital accumulation plan are matched by employer payments, and the ceiling on employee contributions eligible for such matching dollars. Some employees will contribute the full amounts permitted by the plan specifications, others only some, still others not at all. The percent of full participation is the net average of full participation after all full, partial, and zero contributions have been combined.

The cost to the Federal Government of the capital accumulation plans is established by multiplying the matching rate specified for the plan by the estimated percent of full participation. For example, a plan with a 50 percent employer match of employee contributions to six percent of pay is estimated to acquire a 55 percent average full participation. Multiplying that rate times the maximum government match (three percent) yields a Federal Government cost for the plan of 1.65 percent of pay.

This proposal includes a capital accumulation plan that permits the employees to contribute as much as 10 percent of their salaries, with the first four percent matched on a two for one basis. The phased vesting of 25 percent of the matching amount for years two through five would reduce the cost to the government approximately .1 percent, as employees who separated with less than five years of service lost portions of the matching amount. Thus, at a 78 percent rate of full participation, employees would contribute an average of slightly over 3.1 percent of salary, and the Federal Government's matching cost would be 6.1 percent of pay. Documentation of the method for arriving at the variable used for the capital accumulation cost assumptions is available from CRS.

21 FEB 1985

Comments on Stevens' Bill

- Stevens' plan is focused on reducing costs.

  Example:

Estimated cost to government	=	24% (includes social security)
Cost of current CSRS	=	27%
Cost of current CIARDS	=	47%
Aggregate cost of CIARDS/CSRS	=	40%

- Defined benefit provision (accrual rate of .85%) is less than half that of current CSRS and CIARDS and does not pay full benfits until age 62 verus age 50 for CIARDS and age 55 for CSRS.

Example:

Assume no voluntary contributions from employee.

GS-13 employee age 55 with 30 years of service would receive about $9,029 from Stevens defined benefit at age 55 plus social security at age 62.

Under current CSRS provisions employee would receive $23,159 at age 55.

- This places heavy reliance on employee to build up annuity through voluntary contributions.

- Too heavy emphasis on voluntary defined contribution provisions - potential for lower graded employees to opt not to participate.

  According to Hustead, insufficient annuity derived from defined contribution programs to support early retirement, i.e. age 50 under CIARDS and age 55 under CSRS.

  Defined contribution plans encourage employees to stay longer to achieve larger benefits needed to sustain retirement.

  Conversely, portability features (social security and defined contribution portion) encourage turnover of younger mid-level employees.

<u>Assessment</u>

Stevens' plan incompatible with agency needs and objectives for reasons cited above.

- Early retirement would disappear.

- Maintenance of effective work force would be hampered by:

  Increased turnover of younger, marketable employees.

Fewer voluntary retirements at earlier ages.

° DCI management flexibility severely hampered. Could not maintain young and vigorous concept without forcing employees to separate earlier than when annuities are adequate to support retirement.

Summary of the Proposed

Civil Service Pension Reform Act of 1985

(Stevens' Bill)

[A Bill to amend title 5, U.S.Code, to establish a new retirement and disability plan for federal employees, postal employees, and members of Congress, and for other purposes.]

Purposes

- To provide federal employees with a retirement plan comparable to good private section plans; promote financial stability and flexibility for the future of each federal employee; ensure a fully funded and financially sound federal government retirement plan; enhance portability of retirement assets between federal jobs and jobs outside the federal government; increase options of each federal employee with respect to retirement plans; encourage federal employees to increase personal savings; include federal employees in the investment decision-making process with respect to the assets of the retirement system; and extend financial protection from disability to additional federal employees and increase such protection for eligible federal employees.

BASIC PLAN

Entitlement

- Age 55 w/30 years service - immediate annuity
- Age 62 w/10 years service - immediate annuity
- Age 55 w/25 years service
  as law enforcement officers,
  firefighters or
  air traffic controllers - immediate annuity
- Any age w/25 years service or not less than age 50 w/20 years service if separated involuntary under certain circumstances - immediate annuity

Deferred Retirement

- Under age 62 and separates after 10 years civilian service-entitled annuity when reaches age 62

Computation of Annuity

- Except for reduction for early retirement (see Reduction for Early Retirement below), the annuity shall be equal to the product of 0.85 of average pay (hi-5) multipled by the number of total years of service.

- An annuity supplement equal to the amount of social security benefits paid at age 62 will be paid to "special" annuitants under age 62 until they reach age 62 and qualify for Social Security.

Reduction for Early Retirement

- Annuity reduced by one-sixth of one percent for each full month under age 62 on date of separation except law enforcement officers, fire fighters or air traffic controllers (these may retire at age 55 w/25 years with no reduction in annuity) This formula is equivalent to a reduction of 2% each year.

Reduction for Survivor Annuities

- Annuity reduction to provide survivor annuity to spouse of a married participant unless both jointly waive spouse's right to survivor annuity.

- Annuity reduction when participant has a former spouse who is entitled to survivor annuity.

Funding

- Employing Agency shall contribute an amount equal to the normal cost of an annuity for each participant.

Survivor Benefits

- Provides payment of death benefits from basic plan to retiree's survivor unless the surviving spouse waived a survivor annuity.

- Survivor age 60 or over no children under age 16 - 50% of the unreduced annuity (except for early retirement deduction) plus any social security payable.

- Survivor under age 60 with no children of the retiree under age 16 gets full annuity that was payable to the retiree (after deductions for early retirement and survivor benefits) until age 60, when they get 50% of the covered annuity after early retirement reductions plus any social security payable.

- Survivor under age 60 with children of the retiree under age 16 gets 50% of the unreduced annuity plus social security payable.

- Provide for survivor benefits from the Thrift Savings Plan.

Cost-of-living Adjustments

- Annual adjustment to basic pension of the consumer price index minus 2 percentage points. Adjustments made in January and based on the change from September to September.

Transition Provisions

- CSRS participants may elect to transfer to CSPS, or, begin participation in CSPS and retain accrued credit for entitlements to benefits under CSRS for service subject to that system.

Disability Benefits

- Disability benefits available to participants who have at least 18 months service.

- Entitlements to receive benefits while under age 62.

- At age 62, annuity payable under the basic plan provision based on at least 10 years actual service plus projected service through age 62.

- If eligible for Social Security, or ineligible for social security only as a result of insufficient quarters of coverage, 60 percent of the high-five salary minus 100 percent of the social security benefit.

- If ineligible for social security, 60 percent of the high-five salary for the first year after which, 20 percent of the high-five or the accrued benefit based on projected service through age 62, whichever is lower.

Conforming Provisions for Other Retirement Systems

- Old CIARDS unaffected, would require legislation for established supplemental program for future CIARDS participants hired after 1 January 1984. Excludes employees from participation in both the CSPS and CIARDS.

THRIFT SAVINGS PLAN

Contributions

- In any fiscal year, participant may contribute any amount not exceeding 10 percent of annual rate of basic pay.

- Employing agency shall contribute an amount equal to twice such portion of the amount of the participant contribution as does not exceed 4 percent of gross pay.

- Amounts of participants' thrift savings fund contributions and employing agency's matching contributions shall not be included in gross income of participant for purposes of the Internal Revenue Code of 1954.

Vesting

- Participants immediately vest in their contributions and their earnings. Beginning at two years of service, participants vest in 25 percent of their contributions. This increases 25 percent each additional year up to five years and beyond, when the entire share contributed by the employer, plus interest, is vested. Participants who die while employed immediately vest in 100 percent of employer's contribution and earnings on it.

Entitlements

- Permits participants who separate from government employment, either entitled or not entitled to an immediate annuity, to elect method of receiving money credited to their accounts.

Annuities

- A thrift investment board will prescribe methods of payment the amounts of which will be determined in accordance with generally accepted actuarial principles.

Civil Service Thrift Investment Board

- Established as an independent establishment in the executive branch of the Federal Government;

- Composed of 6 members appointed by the President, by and with the advise and consent of the Senate;

- An Executive Director appointed by the majority of the members;

- Board shall establish policy, prescribe regulations and administer the Thrift Savings Fund.